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SPECIAL REPORT

Multi-Housing Capital Markets

A Primer on Investing in Apartments

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A PRIMER ON INVESTING IN MULTI-HOUSING

Over the last twenty years, institutional investors in the United States have significantly increased ownership of apartment properties. Multi-housing is now the second largest real estate holdings behind office for institutional investors. During this period, the multi-housing sector has established itself as having the best track record of risk-adjusted returns and recognized diversification benefits for real estate portfolios. Apartment properties in the U.S. present investors with a wide range of choices in terms of product, location and advantageous debt financing, which provides the ability to pursue all types of strategies.

Despite broad recognition as one of the largest real estate sectors in the nation and healthy investment demand for this asset class, multi-housing still remains overlooked by foreign capital. Even as foreign investment in U.S. real estate surged in recent years, multi-housing remains well behind other property types. In fact, only 8% of foreign capital invested in U.S. real estate in 2007 was used to acquire multi-housing. It is our sense that because multi-housing properties in the U.S. are part of a market whose structure and operation is quite different from those in other countries there is not the same level of experience, and therefore comfort, by foreign capital in investing in this product.

The purpose of this primer is to summarize the benefits of investing in apartment properties in the United States from the historical performance perspective and to highlight key factors helping this sector maintain its status as a top performer:

- Multi-housing has a long track record of the highest risk-adjusted investment returns compared to other property types
- Multi-housing brings diversification benefits to real estate portfolios
- Multi-Housing is still under-weighted in institutional real estate portfolios relative to its share of the total real estate market

- Multi-housing has the highest cash distribution due to low capital expenditures and technical improvements
- Multi-housing has lower cost of capital and wider availability of debt capital
- Multi-housing operates in a favorable, transparent and market-driven environment
- Multi-housing properties vary widely in terms of age, size, quality, and location creating a broad spectrum of opportunities and investment strategies
- Multi-Housing market fundamentals are favorable

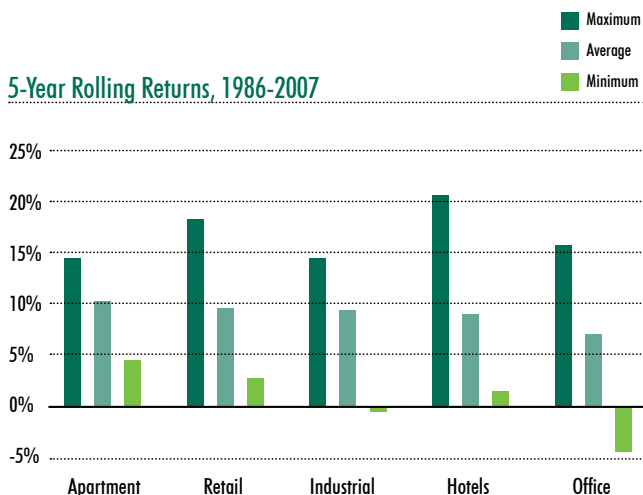
INVESTMENT CONSIDERATIONS

Multi-housing has a long track record of the highest risk-adjusted investment returns compared to other property types

Among all the major property types, multi-housing has provided the highest returns as well as the smallest amount of variation in those annual returns. Since 1978, the average annual apartment return was 12.1% compared to 10.3% achieved by the National Property Index which tracks performance of apartment, office, industrial, retail and hotel properties privately held by U.S. institutional investors. In fact, adjusting for temporal variation in returns, apartments have outperformed every other property type over the last 25, 20, 15 and 10-year periods and were second only to retail over the last 5 years.

Another way to compare property sectors is to look at average returns and the volatility of returns over the rolling five-year holding periods, which are typical for real estate. Such an analysis also confirms that apartments have had the highest average returns and the lowest standard deviation. In addition, even the weakest historical apartment performance was still higher on average compared to other sectors, yet another indication of their relatively low risk profile.

5-Year Rolling Returns, 1986-2007



Source: NCREIF

The lower investment risk associated with multi-housing can be explained by several factors. In general, apartments have more consistent demand than other property types, as well as shorter leasing cycles, with a one year average lease. Apartment buildings also have a shorter development cycle than other property types, averaging 12 to 14 months. Consequently, the rental market for apartments is much more responsive to price changes and this sensitivity helps maintain price levels close to equilibrium. Contrast this to the office sector, for example, which has seen the highest amount of volatility over the same period, due in part to a longer building cycle (18 to 30 months), the longer lease structure (5 to 10 years), and the propensity to overbuild in the face of falling demand due to the length of the building cycle.

Multi-housing brings diversification benefits to real estate portfolios

In addition to having the highest risk-adjusted returns historically, apartments have also displayed high returns when other property sectors underperformed, thus bringing diversification benefits when added to real estate portfolios. This is evidenced by a comparison of risk-adjusted returns and variation in returns by property type relative to real estate as a whole. As a result, the multi-housing sector represents a desirable investment option for buyers with a lower risk tolerance. Apartment investors have the ability to generate excess returns

through property management and strategic utilization of property rehabilitation capital and are adequately compensated for the risks they take.

Multi-housing is still under-weighted in institutional real estate portfolios relative to its share of the total real estate market

Over the last twenty years apartments have become a widely accepted investment for institutional capital. Multi-housing share of institutionally-owned private real estate grew from less than 3% in the early 1980s to over 23% today, making it the second highest concentration among property sectors behind office assets in privately-held portfolios. While the growing acceptance of apartments has raised the institutional share to exceed those of the longer-established retail and industrial property types, this sector still remains under-weighted in real estate portfolios relative to its share of the total real estate market value in the United States, where it accounts for over 35%.

More recently, the increasing acceptance of apartments as institutional investments and the aggressiveness with which investors have been pursuing these investments has contributed to the higher return performance through greater appreciation. While the institutional share of multi-housing ownership has increased, heavy competition from individual investors – who own more than 50% of the apartment product – should be noted as a contributing factor to strong return performance and, at times, more aggressive pricing.

| Source | Apartment Acquisitions, \$ Bil. | | | | |
|--------------|---------------------------------|-------------|-------------|--------------|-------------|
| | 2003 | 2004 | 2005 | 2006 | 2007 |
| Private | 18.8 | 32.7 | 58.7 | 52.8 | 52.2 |
| Institutions | 4.3 | 6.7 | 11.8 | 24.9 | 14.3 |
| Funds | 2.2 | 3.9 | 9.4 | 13.8 | 9.2 |
| REITs | 3.6 | 7.1 | 11.1 | 7.8 | 5.4 |
| Foreign | 0.4 | 1.1 | 2.3 | 2.9 | 3.8 |
| Syndicators | 0.1 | 1.1 | 2.2 | 2.2 | 2.0 |
| Total | 29.4 | 52.5 | 95.6 | 104.4 | 86.9 |

Source: Real Capital Analytics

Multi-housing has the highest cash distribution due to low capital expenditures and technical improvements

If much of the difference in total returns historically can be attributed to a higher yield, credit must be given to apartment managers' ability to translate net income into cash available for distribution. While historic average cap rates do not vary widely by property type from each other, there is a significant difference in the costs taken out "below the line" for each property type. These costs include capital expenditures as well as tenant improvements and leasing commissions. The ratio of income that translates into cash flow versus the income that is declared as net operating income is known as the income efficiency ratio. While apartments translate 83% of NOI into cash flow, other property types range between 64% and 74%. As a percent of value, this puts multi-housing returns from income as much as 160 basis points above other property types.

Multi-housing has lower cost of capital and wider availability of debt capital

The multi-housing sector's track record of stable performance coupled with the low cost debt provided by Fannie Mae and Freddie Mac results in a lower cost of capital while allowing for a greater availability of debt capital. Evidence of investor sentiment toward the different property sectors can be seen in the way the lenders have been pricing debt. Historically and currently, multi-housing has seen more favorable debt pricing as measured by spread over the U.S. Treasury bonds than the other sectors. Even in today's turbulent credit environment apartments are enjoying relatively tight spreads for the higher quality assets, especially for lower leverage deals. Such variation in spreads also reflects the expectation that return volatility and risk of apartments will remain low going forward.

Another factor contributing to wider availability of debt financing for multi-housing has been active participation in this market by Fannie Mae and Freddie Mac, the Government-Sponsored Enterprises (GSE), which are chartered by the U.S. Congress to create a continuous

flow of funds to mortgage lenders in support of homeownership and rental housing. GSE share of multi-housing residential mortgages grew substantially over the past decade and their capital has become a reliable source of liquidity for the industry as a whole.

Multi-housing operates in a favorable, transparent, and market-driven regulatory environment

The U.S. apartment market has a number of structural and regulatory advantages that make it attractive from an investment standpoint. For example, the share of "social" (subsidized/low-income) housing in the U.S. (5-10%) is lower by comparison with many European markets where rents are often heavily regulated by local and federal governments and inventory of regulated units can account for 15-25% of the overall inventory.

Furthermore, the U.S. housing market is highly transparent: in addition to decennial, bi-annual, annual, and quarterly government surveys of rents and vacancies at the national and municipal level, a number of private surveys of investment-grade apartments are conducted on a quarterly, monthly, and even daily basis.

The relative advantages of the U.S. multi-housing market are reflected in the place this property type occupies on the domestic investment landscape compared to other countries. For example, according to the London-based Investment Property Databank (IPD) as recently as 2006 there has been no institutional investment in residential real estate in Australia, Belgium, United Kingdom, Ireland, Italy, Norway, Portugal, and South Africa.

Multi-housing properties vary widely in terms of age, size, quality, and location creating a broad spectrum of opportunities and investment strategies

There are over 25,000 investment-grade apartment properties in the U.S. Well over half of the stock of units in such properties is concentrated in the 25 largest markets. These professionally-managed apartments do vary by age, size (from 50 units to over 1,000 units), type ("garden-style" vs. "high-rise"), quality (class A, B, or C), or location within markets (downtown vs. suburban).

Such a relatively broad playing field provides investors with potential for geographical and product diversification and allows owners to devise and implement various investment strategies. In addition to traditional market-rate apartment properties, there are also specialized multi-housing properties for seniors, students, and low-income households – all of which are gaining attention among investors looking for new “niche” sectors.

25 Largest Markets* Based on Stock of Units in Properties with 50 or More Units in Structure

| Market | Stock of Units in Properties with 50 or More Units in Structure | | | |
|---------------------------|-----------------------------------------------------------------|---------|-----------|----------|
| | Total | Owner | Renter | % Renter |
| | Occupied | | | |
| New York | 1,036,559 | 259,987 | 776,572 | 74.9 |
| Los Angeles | 257,680 | 32,597 | 225,083 | 87.3 |
| Chicago | 229,722 | 81,449 | 148,273 | 64.5 |
| Miami | 125,005 | 54,521 | 70,484 | 56.4 |
| Washington DC | 153,126 | 36,551 | 116,575 | 76.1 |
| Fort Lauderdale | 85,384 | 52,372 | 33,012 | 38.7 |
| Boston | 110,428 | 22,936 | 87,492 | 79.2 |
| Houston | 106,418 | 7,989 | 98,429 | 92.5 |
| Minneapolis | 93,591 | 17,074 | 76,517 | 81.8 |
| Philadelphia | 77,551 | 13,902 | 63,649 | 82.1 |
| San Diego | 78,247 | 10,392 | 67,855 | 86.7 |
| Orange County | 79,106 | 6,829 | 72,277 | 91.4 |
| Dallas | 69,249 | 4,374 | 64,875 | 93.7 |
| San Francisco | 63,060 | 12,014 | 51,046 | 80.9 |
| Seattle | 66,073 | 9,579 | 56,494 | 85.5 |
| Detroit | 57,980 | 3,586 | 54,394 | 93.8 |
| Phoenix | 64,285 | 5,829 | 58,456 | 90.9 |
| Oakland | 56,327 | 6,271 | 50,056 | 88.9 |
| Atlanta | 54,305 | 8,683 | 45,622 | 84.0 |
| Cleveland | 52,838 | 4,705 | 48,133 | 91.1 |
| Tampa | 49,013 | 18,989 | 30,024 | 61.3 |
| Honolulu | 44,723 | 19,538 | 25,185 | 56.3 |
| San Jose | 53,887 | 4,327 | 49,560 | 92.0 |
| Denver | 47,173 | 8,119 | 39,054 | 82.8 |
| West Palm Beach | 31,390 | 18,285 | 13,105 | 41.7 |
| Subtotal | 3,143,120 | 720,898 | 2,422,222 | 77.1 |
| Subtotal as % U.S. | 63.8 | 83.2 | 59.6 | |
| United States | 4,929,058 | 865,959 | 4,063,099 | 82.4 |

* Metropolitan areas and divisions.

Source: Bureau of the Census, 2006 American Community Survey.

SPACE MARKET CONSIDERATIONS

Rental demand is expanding

Demand for rental housing in the U.S. is expanding at the strongest pace since the mid-1980s and apartments are benefiting greatly from this trend as their market share continues to edge higher. Over a three-year period ending in 2007, over 2.5 million households were added to national rental demand as a result of new household formation and declining homeownership rate. With this gain, rental demand has not only fully recovered the losses it sustained over the last decade but surpassed the previous peak.

Total Housing Stock*

| Units in Structure | Renter-Occupied Units | | | % Total | |
|--------------------|-----------------------|--------|---------|---------|-------|
| | 1995 | 2005 | %Change | 1995 | 2005 |
| 1 detached | 8,569 | 8,297 | -3.2 | 25.1 | 24.4 |
| 1 attached | 2,609 | 2,182 | -16.4 | 7.6 | 6.4 |
| 2-4 | 7,565 | 6,829 | -9.7 | 22.2 | 20.1 |
| 5-9 | 4,283 | 4,607 | 7.6 | 12.5 | 13.6 |
| 10-19 | 3,974 | 4,175 | 5.1 | 11.6 | 12.3 |
| 20-49 | 2,903 | 3,203 | 10.3 | 8.5 | 9.4 |
| 50+ | 2,920 | 3,222 | 10.3 | 8.6 | 9.5 |
| Other | 1,328 | 1,424 | 7.2 | 3.9 | 4.2 |
| Total | 34,151 | 33,939 | -.06 | 100.0 | 100.0 |

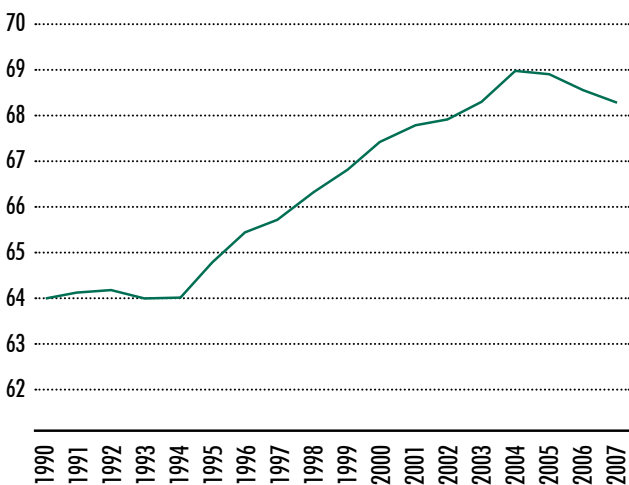
* Including seasonal homes

Sources: 1995 and 2005 America Housing Surveys.

The broad rental demand will continue growing rapidly over the next five years supported by favorable demographic trends. Growth in population aged 20 to 29—the group with the highest propensity to rent—is resuming after two decades of decline, and growth in population aged 50-and-over is so strong already that, even with its high homeownership rate this group is now contributing more to rental demand than the so-called “prime renters”. Moreover, a trend toward “lifestyle renting” among the middle-aged households has also emerged as one of the forces shaping renter demand in recent years. Steady foreign immigration and the increasing diversity of the U.S. population are also among the key contributing factors.

Economic trends favor renting too. In most markets today, costs of renting are still lower than the costs of owning (especially when accounting for rising energy costs and property taxes) and will likely to remain so even if home prices decline by 15 to 20%. Rental demand will also see additional near-term boost from rising foreclosures, as sub-prime and risky adjustable-rate mortgages reset, and also from higher barriers to homeownership as a result of tightening lending practices.

Homeownership rate, %

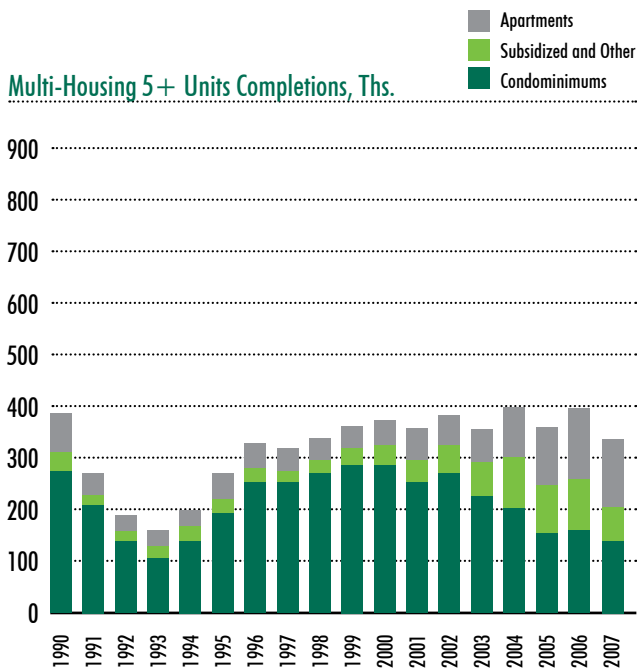


Source: Bureau of the Census

Multi-housing supply is slowing

Completions of market-rate apartments (properties with 5 units or more) have been declining in this decade from 230,000 units in 2000 to about half that figure last year. Moreover, about 200,000 existing apartment units have been converted to condominiums at the peak of the latest housing boom.

It should be noted however that in some markets completions of new condominiums are elevated and still rising despite falling sales and prices. Since condominiums are the closest product substitute for rental multi-housing, apartment investors should carefully evaluate supply-side risks across markets and submarkets. These risks are concentrated in about a dozen markets, where a large share of new condominium development was catering to investors and speculators.



Source: Bureau of the Census

On the upside, this environment could also create unique opportunities in the near term. As distressed, new and recently converted condominium projects slash the prices of individual units in order to attract buyers, whole properties may eventually become rather attractive options for apartment investors. Because of low dollar exchange rates, foreign buyers are in a particularly strong position.

There are a number of factors that make a compelling argument as to why we believe foreign capital should increase their investment in U.S. multi-housing over the next five to ten years. Higher returns, lower volatility, institutional ownership, professional management, balanced new supply, falling home ownership rates, greater availability of debt capital and liquidity and favorable rental demographics and immigration patterns are all positive factors when considering investing in U.S. multi-housing.

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